



## Senate

General Assembly

**File No. 48**

January Session, 2009

Substitute Senate Bill No. 764

*Senate, March 10, 2009*

The Committee on Insurance and Real Estate reported through SEN. CRISCO of the 17th Dist., Chairperson of the Committee on the part of the Senate, that the substitute bill ought to pass.

### **AN ACT CONCERNING DERIVATIVE FINANCIAL TRANSACTION CONTROLS.**

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. Section 38a-54 of the general statutes is repealed and the  
2 following is substituted in lieu thereof (*Effective from passage*):

3 (a) Each domestic insurance company, health care center or fraternal  
4 benefit society doing business in this state shall have an annual audit  
5 conducted by an independent certified public accountant and shall  
6 annually file an audited financial report with the commissioner, and  
7 electronically to the National Association of Insurance Commissioners  
8 on or before the first day of June for the year ending the preceding  
9 December thirty-first. An electronically filed true and complete report  
10 timely submitted to the National Association of Insurance  
11 Commissioners does not exempt a domestic insurance company or  
12 health care center from timely filing a true and complete paper copy to  
13 the commissioner.

14 (b) Each foreign insurance company or fraternal benefit society  
15 doing business in this state shall have an annual audit conducted by an  
16 independent certified public accountant and shall annually file an  
17 audited financial report with the commissioner, and electronically to  
18 the National Association of Insurance Commissioners, on or before  
19 June first for the year ending the preceding December thirty-first. An  
20 electronically filed true and complete report timely submitted to the  
21 National Association of Insurance Commissioners shall be deemed to  
22 have been submitted to the commissioner in accordance with the  
23 provisions of this section.

24 (c) (1) No domestic or foreign insurance company doing business in  
25 this state shall enter into derivative financial transactions, including  
26 swaps, options, forwards, futures, caps, floors and collars or similar  
27 instruments or combinations thereof, without the authorization of the  
28 commissioner. Any such company receiving such authorization shall  
29 include in its audited financial report a statement by the independent  
30 certified public accountant conducting such audit that describes such  
31 accountant's assessment of the internal controls of such company  
32 relative to such derivative financial transactions.

33 (2) If the independent certified public accountant determines the  
34 internal controls relative to such derivative financial transactions to be  
35 deficient, (A) such accountant shall include in the statement set forth in  
36 subdivision (1) of this subsection a description of such deficiencies,  
37 and (B) the insurance company shall append a description of remedial  
38 actions taken or proposed to be taken to correct such deficiencies, if  
39 such actions are not already described in the accountant's assessment.

40 (3) For the purposes of this subsection:

41 (A) "Swap" means a contract to exchange, for a period of time, the  
42 investment performance of one underlying instrument for the  
43 investment performance of another underlying instrument without  
44 exchanging the instruments themselves;

45 (B) "Option" means a contract that gives the purchaser the right, but

46 not the obligation, to enter into a transaction with the seller for option  
 47 rights on terms specified in the contract;

48 (C) "Forward" means a contract, other than a future, between two  
 49 parties that commits one party to purchase and the other to sell the  
 50 instrument or commodity underlying the contract on a specified future  
 51 date;

52 (D) "Future" means a standardized forward contract traded on a  
 53 United States or qualified foreign exchange;

54 (E) "Cap" means an option contract wherein the seller, in return for a  
 55 premium, agrees to limit the purchaser's risk associated with an  
 56 increase in a reference rate or index;

57 (F) "Floor" means an option contract wherein the seller, in return for  
 58 a premium, agrees to limit the purchaser's risk associated with a  
 59 decline in a reference rate or index; and

60 (G) "Collar" means a contract that combines a cap and a floor.

61 [(c)] (d) The commissioner shall adopt regulations, in accordance  
 62 with the provisions of chapter 54, to: (1) Specify the scope of the  
 63 examination required by this section; (2) specify the contents and scope  
 64 of the annual audited financial report, provided such report shall  
 65 include all incurred losses; (3) specify the permitted usage of  
 66 derivative transactions; (4) provide for the review of the controls; [(4)]  
 67 (5) provide for the availability to the commissioner of the workpapers  
 68 of the certified public accountant; and [(5)] (6) provide exemptions  
 69 from compliance with the requirements of this section.

This act shall take effect as follows and shall amend the following sections:		
Section 1	<i>from passage</i>	38a-54

***Statement of Legislative Commissioners:***

The first sentence of subsection (c)(1) was rewritten for clarity, and in subsections (c)(1) and (c)(2), "derivative transactions" was changed to "derivative financial transactions" for statutory consistency.

***INS***        *Joint Favorable Subst.*

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either House thereof for any purpose:

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### **OFA Fiscal Note**

#### **State Impact:**

Agency Affected	Fund-Effect	FY 10 \$	FY 11 \$
Insurance Dept.	IF - Indeterminate	See Below	See Below

Note: IF=Insurance Fund

**Municipal Impact:** None

#### **Explanation**

The fiscal impact of this bill is indeterminable as it is unclear whether the Department of Insurance (DOI) is required to authorize all derivative financial transactions (transactions) before they are entered into by insurers, requiring DOI to review all individual transactions, or whether DOI can authorize the processes through which insurers enter into transactions and not the transactions themselves. If the bill requires DOI to authorize individual transactions, there would be a cost to DOI, as the agency would need additional staff to complete reviews of each of these transactions.

DOI estimates that the number of transactions entered into by domestic companies annually in the state is over 100,000. This does not include the transactions of foreign insurance companies. Foreign companies, according to DOI estimates, will process more than five times the number of derivative transactions as domestic companies. The combined estimated number of derivative transactions for domestic and foreign companies, therefore, is more than 600,000 annually.

#### **The Out Years**

The annualized ongoing fiscal impact identified above would continue into the future subject to bill interpretation.

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**OLR Bill Analysis****sSB 764*****AN ACT CONCERNING DERIVATIVE FINANCIAL TRANSACTION CONTROLS.*****SUMMARY:**

This bill prohibits a U.S. insurer doing business in Connecticut from entering into derivative financial transactions without the insurance commissioner's authorization. Such transactions include swaps, options, forwards, futures, caps, floors, collars, and similar instruments or combinations of them.

If an insurer receives authorization, the bill requires the insurer to include in its statutorily required audited financial report a statement from the independent certified public accountant (CPA) who audited the insurer. The statement must include the CPA's assessment of the insurer's internal controls relative to the transactions.

If the CPA determines the internal controls are deficient, (1) the CPA's statement must describe the deficiencies and (2) the insurer must attach a remedial action plan, if the CPA's statement does not include one. The remedial action plan must identify actions the insurer has taken or will take to correct the deficiencies.

By law, the commissioner must adopt regulations regarding audited financial statements. The bill requires the commissioner to specify in the regulations the permitted use of derivative transactions.

EFFECTIVE DATE: Upon passage

**DEFINITIONS**

Under the bill, a "swap" is a contract to exchange, for a period of time, the investment performance of one underlying instrument for the

investment performance of another without exchanging the instruments themselves. An “option” is a contract that gives the purchaser the right, but not the obligation, to enter into a transaction with the seller for option rights on specified terms.

The bill defines “forward” as a contract, other than a future, between two parties that commits one to purchase and the other to sell the instrument or commodity underlying the contract on a specified future date. A “future” is a standardized forward contract traded on a United States or qualified foreign exchange.

The bill defines a “cap” as an option contract under which the seller, in return for a premium, agrees to limit the purchaser's risk associated with an increase in a reference rate or index. If the option contract is a “floor,” the seller agrees to limit the purchaser's risk associated with a decline in a reference rate or index. A “collar” is a contract with both a cap and a floor.

## **COMMITTEE ACTION**

Insurance and Real Estate Committee

Joint Favorable Substitute

Yea 15      Nay 4      (02/24/2009)